September 09, 2019 Revised

Kirloskar Ferrous Industries Limited: Ratings reaffirmed; Rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	100.00	100.00	[ICRA]A1+; reaffirmed
Fund-based - Term Loan	60.00	188.00	[ICRA]AA-(Stable); reaffirmed
Fund-based - Working Capital Facilities	455.00	455.00	[ICRA]AA-(Stable)/ [ICRA]A1+; reaffirmed
Non-fund Based - Working Capital Facilities	690.00	690.00	ICRA] AA-(Stable)/ [ICRA]A1+; reaffirmed
Total	**1,305.00**	**1,433.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reaffirmation derives comfort from the established position of Kirloskar Ferrous Industries Limited (KFIL) in foundry-grade pig iron manufacturing and ferrous castings, its backward integration measures to limit the price volatility in raw materials (iron ore and coking coal), which are expected to fructify in the near term, and healthy financial profile. The company is a part of the reputed Pune-based Kirloskar Group with a proven management track record. KFIL's operating income witnessed a healthy growth of 22% in FY2019 led by an increase in pig iron and foundry volumes. The company is undertaking cost optimisation capital expenditure (capex) by installing a coke oven plant (for converting coal into coke), which is expected to reduce its exposure to the volatility in coke prices. The waste gas generated by the oven will be harnessed by a 20-MW power plant, which will result in additional power and fuel savings for the Hospet (Karnataka) facility. The company was also declared as the preferred bidder for two iron ore mines in Karnataka that will further facilitate cost control and ensure a regular iron ore supply. The company continues to have a comfortable capital structure with a low gearing of 0.2 time as on March 31, 2019, and adequate liquidity position characterised by modest cash accruals and sizeable unused bank lines.

The rating strengths are partially offset by the vulnerability of the operating margins to fluctuating raw material prices, given the commoditised nature of the business. The sizeable debt-funded capex planned over the next two years (FY2020-FY2021) will impact the debt protection metrics to some extent (though the same will remain comfortable). The ratings are also constrained by the casting division's exposure to an inherent demand cyclicality in the key end-user segments (both commercial vehicle and tractor segments) that impacted past operating performance, and a relatively high customer concentration. However, this risk is mitigated to some extent due to established relations with large original equipment manufacturers (OEMs) with a healthy share of business. ICRA also notes the company's exposure to foreign currency movement, given the sizeable imports; although, the company adopts conservative hedging policies to minimise impact of the forex risk.

The Stable outlook on the [ICRA]AA- rating reflects ICRA's opinion that KFIL will continue to benefit from its long track record of operations, healthy financial risk profile, and extensive management experience.

Key rating drivers and their description

Credit strengths

One of the leading pig iron players in domestic market - KFIL is one of the leading players in foundry-grade pig iron manufacturing and ferrous castings in the domestic market. It has an established performance track record over the years. The company is a part of the reputed Pune-based Kirloskar Group, with a presence across diversified business segments and a proven management track record. The company has a competitive cost structure for pig iron manufacturing, because of the presence of its sinter plant and hot blast stoves.

Backward integration to enable control of raw material costs - The company is installing a coke oven plant to convert coal into coke, which will reduce its dependence on imported coke and exposure to volatility. In 2018, KFIL was declared as the preferred bidder of two iron ore mines in Karnataka. This will ensure a regular supply of iron ore and fulfil a part requirement of raw material once the mines are functional. In the casting division, the Hospet foundry enjoys the benefit of backward integration in the form of ready availability of molten pig iron.

Established relations with OEMs help increase casting volumes - KFIL has established relations with OEMs for its castings manufactured and enjoys a healthy share of their businesses. In the last few years, consistent addition of clients led to an improvement in the casting volumes. This, coupled with an increasing share of machined casting, will help the company improve profitability of this division.

Debt protection metrics to remain comfortable despite sizeable capex over next two years - KFIL maintained a strong financial profile with a gearing of 0.2 time and TD/OPBDITA of 0.6 time in FY2019. The company's liquidity profile also remains comfortable with modest accruals and sizeable unused bank lines, which further help its financial flexibility. The company is, however, undertaking sizeable capex over FY2020-FY2022, partly funded by debt, for a coke oven plant and capacity expansion to keep up with the increasing demand. ICRA expects the company to maintain comfortable debt protection metrics, supported by increased internal accruals due to significant cost savings from these projects.

Credit challenges

Raw material price volatility and foreign currency movement risks - Raw materials account for a major portion of the operational cost for pig iron players, including KFIL, and are thus important determinants of profitability. Since the pig iron business is cyclical in nature, it is exposed to margin risks arising from temporary mismatches in the prices of raw materials and pig iron, causing volatility in profitability and cash flows. Going forward, the company's planned backward integration facilities will help reduce such a risk to an extent. Given the sizeable imports, the company's profitability remains exposed to foreign currency movements. The company, however, adopts conservative hedging policies to minimise the impact of forex volatility.

Casting division performance exposed to inherent cyclicality in key end-user segments - KFIL's casting division derives ~90% of sales from commercial vehicle and tractor segments, which are both exposed to inherent demand cyclicality. Any sustained weak demand from its key end-user segments, as witnessed in the recent months, would adversely impact its revenues and earnings profile.

Client concentration risk in casting division - The company faces client concentration risk in the casting division. The top customer contributes ~29% to its casting revenues, while the share of its top five customers is ~74%. However, the company has a healthy share of business with its key customers, and in the last few years, it added new clients to its portfolio. This mitigates the client concentration risk to some extent.

Liquidity position: Adequate

KFIL's liquidity is **adequate** with healthy cash flow from operations of nearly Rs. 130.0-140.0 crore, a capex commitment of Rs. 238 crore in FY2020 (Which will be partly funded by debt), and moderate working capital utilisation levels. KFIL's debt repayments, at Rs. 16 crore in FY2020 and estimated amount of Rs. 65 crore in FY2021, also remain modest.

Overall, ICRA expects KFIL to be able to meet its near-term commitments through internal as well as external sources of cash, and yet be left with sufficient cash surpluses.

Rating sensitivities

Positive triggers - ICRA could upgrade KFIL's rating if its capex plans achieve the desired level of returns with operating margins remain above 10% on sustained basis.

Negative triggers - Negative pressure on KFIL's ratings could arise if profitability and cash accrual are lower than expected due to volatility in raw material prices and weak demand for automotive castings, leading to Total Debt/OPBITDA exceeds 2.25 times.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Ferrous Metals Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on standalone financial statements of the rated entity.

About the company

KFIL, incorporated in 1991, is a part of the Pune-based Kirloskar Group. KFIL manufactures pig iron, and ferrous castings such as cylinder blocks, cylinder heads, axles and transmission parts, and different types of housings required by automobile, tractor and diesel engine industries. KFIL's plants in Hospet (Karnataka) and Solapur (Maharashtra) have a combined casting capacity of 1,50,000 metric tonne per annum (MTPA). It also has a combined pig iron capacity of 3,91,400 MTPA at its Hospet plant. The company has three steam turbines with a total power cogeneration capacity of 11.5 megawatt (MW) in its Hospet facility, and a newly-installed 10-MW solar power plant at its Solapur facility, which has become operational in October 2018.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	1,765.2	2,159.5
PAT (Rs. crore)	38.0	98.1
OPBDIT/OI (%)	6.6%	10.3%
RoCE (%)	9.2%	22.7%
Total Outside Liabilities/Tangible Net Worth (times)	1.0	1.1
Total Debt/OPBDIT (times)	0.6	0.6
Interest Coverage (times)	10.6	13.5
DSCR (excluding short-term debt)	9.2	10.9

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2019		FY2018	FY2017
					9-Sep-2019	13-Nov-2018	4-Oct-2018	21-Sep-2017	6-Dec-2016
1	Commercial Paper	Short Term	100.0		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
2	Term Loan	Long Term	188.0	138.0	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Cash Credit/WCDL	Long Term/ Short Term	455.0		[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
4	Letter of Credit and Bank Guarantee	Long Term/ Short Term	690.0		[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Commercial Paper	NA	NA	-	100.00	[ICRA]A1+
NA	Term Loan 1	Apr-2018	7.00%	Apr- 2020	15.00	[ICRA]AA-(Stable)
NA	Term Loan 2	June-2018	8.70%	May- 2022	33.00	[ICRA]AA-(Stable)
NA	Term Loan 3	Apr-2019	8.90%	Mar-2024	70.00	[ICRA]AA-(Stable)
NA	Term Loan 4	Aug-2019	8.25%	Jul-2023	20.00	[ICRA]AA-(Stable)
NA	Term Loan 5*				50.00	[ICRA]AA-(Stable)
NA	Fund based Bank Facilities	NA	NA	NA	455.00	[ICRA]AA-(Stable) [ICRA]A1+
NA	Letter of Credit and Bank Guarantee	NA	NA	-	690.00	[ICRA]AA-(Stable) [ICRA]A1+

** Proposed*
Source: Kirloskar Ferrous Industries Limited

Annexure-2: List of entities considered for consolidated analysis: Not applicable

Corrigendum

Document dated September 9, 2019 has been corrected with revision as detailed below:

Revisions:

- Page 4- Total Outside Liabilities/ Tangible Net Worth (times) for FY 2018 in the “Key Financial Indicator” have been corrected

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About ICRA Limited:

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